

SECTION II	(writer)	(div)	(ed)	(copy in)	(stencil)	ORE PICKUPS	SPECIALS
A) GENERAL:	NONE 25X6A		✓	done by 10:30 TUES			
			✓				
			✓	done by 11:00 Tues -			
C) KOREA	ONGJIN PEOPLE'S MINES	✓	✓				UPDATE UNION TALKS
	MILITARY	✓	✓				
D) CHINA	ECP WW III	✓	✓	edited by 1:00 PM			
	ANETHYST	✓	✓				
	NAT. PROTEST ON NE TRADE	✓	✓				
E) VIETNAM							
F) THAILAND	MAP	✓	✓				
G) MALAYA							
H) BURMA							
I) INDONESIA	RECORD-TABLE	✓	✓	2:30			
J) PHILIPPINES	ECONOMICS	✓	✓				
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FAR EAST/PACIFIC BRANCH
OFFICE OF REPORTS AND ESTIMATES
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WORKING PAPER

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OFFICE OF REPORTS AND ESTIMATES, CIA
FAR EAST/PACIFIC BRANCH

INTELLIGENCE HIGHLIGHTS NO. 62
3 AUGUST -- 9 AUGUST 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

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The northern Korean attack in the Ongjin peninsula and the southern Korean limited counteroffensive last week appear to have been only minor readjustments of terrain holdings along the 38th Parallel (p. 3).

Defection of Nationalist forces in Hunan has facilitated the Chinese Communists' progress through that province. In the Northwest, Communist forces are continuing their thrust into remote Kansu (p. 4). Meanwhile, CCP rumors of the impending outbreak of US-USSR hostilities probably are being circulated in order to consolidate the control of the Party's leadership (p. 5).

A defeatist attitude among leading figures in Thailand has not been lessened by the current US arms aid proposal, which is viewed as further evidence of US lack of concern over the fate of Southeast Asia (p. 6).

Preliminary agreements between Republicans and Federalists on many of the points to be raised at the roundtable conference at The Hague, as well as a more conciliatory Dutch attitude, indicate the possibility of a final settlement of the Indonesian problem (p. 7).

The financial picture in the Republic of the Philippines is darker than any time since 1946, due to a sharp fall in government revenues (p. 8).

The marginal notations used in succeeding sections of this Weekly ("A", "B", or "C") indicate the importance of the items in B/FE opinion with "A" representing the most important.

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KOREA

Ongjin incident appears closed--Large-scale fighting again developed on the Ongjin peninsula last week (see Intelligence Highlights #55). The brief battle developed when two battalions of the northern Border Constabulary attacked the Republic of Korea's hill positions along the 38th Parallel. Two ROK Army companies were overrun in the initial advance from the north but other elements of the regiment defending Ongjin regained a portion of the lost ground. Plans for further southern counterattacks, following the arrival of water-borne reinforcements from Inchon, were not carried out and the incident appears to be closed for the present. "B"

Although there have been reports that northern Korean plans call for the complete occupation of the isolated Ongjin peninsula by 10 August, the recent attack did not appear designed to accomplish more than the limited objective of eliminating southern Korean positions on hills slightly north of the 38th Parallel. Although military preparations are being rushed in both northern and southern Korea, it is extremely doubtful that the recent Ongjin fighting is an immediate prelude to the long-threatened civil war.

N. Korean mines seek private aid--A suggestion of possible economic troubles besetting the northern Korean Democratic Peoples' Republic is contained in the announcement of a recent cabinet decision to establish a system of "trust management" for mine development and mineral exploration, designed to encourage private lease and operation of nationalized mines. "C"

In view of the Communist control of northern Korea's economy, this decision to seek "private industrialists and private capital" in the field of mineral exploitation is of particular significance. Efficient utilization of northern Korea's well-developed industrial plant requires a steady

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flow from the area's abundant mineral capacity, almost exclusively under State control. This departure from the State-control pattern would seem to indicate a severe State shortcoming in fulfillment of mine production requirements under the "Two Year Economic Program."

CHINA

Nationalist defections ease Communists' drive South--The defection of two successive Hunan governors, together with the troops under their command, to the Communists during the past week, has given the Communists unopposed entry into Changsha and Hsiangtan, as well as an easy advance to Shaoyang, all important points north and west of Hengyang, the only large defense base remaining to the Nationalists in Hunan. The National Government had removed CHENG Chien, one of the vice-presidential candidates in the Nationalist elections of April, 1948, from his office as provincial governor and ordered his arrest before his defection. His successor, CHEN Ming-jen, reputedly a strong CHIANG man, shortly followed CHENG into the Communist camp. "A"

The forces which defected with these leaders were, for the most part, either local garrisons or troops still in training and their loss will not materially affect PAI Chung-hsi's defensive position in the area. By mid-July, PAI had already withdrawn his best Kwangsi units into their home province and Hengyang probably will not be seriously contested.

In support of this view, Communist troops, which would have been used in any large-scale assault on Hengyang, reportedly are moving southeast to join attacks in the Kanhsien area near the Kwangtung border. Communist success there should open the way for an early advance into Kwantung. Canton, the ultimate Communist objective in the southern drive, is the scene of "feverish" defense preparations, but the Nationalists lack both the means and the will to defend the refugee capital.

In the Northwest, no opposition has impeded the Communist advance into eastern Kansu. Pingliang and Tienhsui, two anchor points of MA Pu-fang's reported defense line, were occupied and the Communists continue to move westward toward Lanchow, capital of Kansu and gateway to Sinkiang. Peiping radio has relayed an order to Communist soldiers in the Northwest, outlining proper forms of behavior, in order to avoid offending Moslem sensibilities. Stiffening resistance by the MAs, however, is expected to halt the present Communist advance before Lanchow is reached.

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Communists bruit threat of US-USSR war--Non-Communist sources in Communist China recently have alleged that CCP leaders anticipate the outbreak of a US-USSR war before the end of 1949. One source asserts that General CHOU En-lai, who has been regarded as friendly to the West as well as to the USSR, has now been persuaded of the imminence of such a war and of the Soviet ability to win it, and has therefore been wholly won over to the USSR.

"B"

There is no available evidence of a Soviet intention to launch a war in the near future. Moreover, if such an intention existed, it is doubtful, first, whether the USSR would inform the CCP of its war plans and, second, whether the CCP would inform the notoriously loose-mouthed splinter-party leaders who are the sources of these allegations. While the CCP has stated frankly that it will ally itself with the USSR in the event of an East-West war, there is little in the CCP's current actions (as distinct from propaganda) to indicate a genuine belief in imminent war.

It is more likely, therefore, that the CCP is spreading the rumor of a war threat without believing in it. Such a threat would be helpful to the Party leadership in explaining to the rank-and-file the special position held by the USSR in the border areas, in consolidating control of the CCP's Stalinist leadership, in justifying the severely repressive aspects of CCP policy, and in enlisting the cooperation of hitherto hostile elements of Chinese society.

Amethyst escape endangers British in China--The British sloop Amethyst's escape from the Yangtze has aroused strong Chinese Communist resentment and probably will lead to retaliatory actions against the British in Hong Kong and in China proper. In belated but virulent reaction to the affair, the Communist press has charged the British authorities with "bad faith" and has asserted that British "imperialists" will be eating "evil fruits" such as the Americans already have digested.

"C"

Confronted by the loss of prestige associated with the Amethyst escape, while facing increased economic difficulties in the lower Yangtze area, the Chinese Communists probably will create serious trouble for the British. Recent reports from Shanghai indicate a Communist belief that the affair has jeopardized the hitherto relatively comfortable British position in Communist China, and a Communist intention to take action on the Hong Kong question as soon as their forces reach the Kowloon frontier. Guerrilla activities, frontier incidents, and other pressures probably will be employed, and overt military action is a distinct possibility. Meanwhile, propaganda campaigns and the now

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familiar pattern of coercive tactics against foreigners probably will be in evidence against the British in Shanghai and perhaps Nanking in the near future.

Nationalists protest USSR-Manchurian trade agreement--The National Government's vigorous protest to the USSR against the recent Soviet-Manchurian trade agreement evidences a Nationalist intention to capitalize on Chinese Communist subservience to Soviet interests. In its formal note to the Soviet Charge in Canton, the Nationalist Foreign Office pointed out that the agreement, concluded with "rebel groups" in Manchuria, violated China's sovereignty and marked a further failure of the USSR to comply with the Sino-Soviet treaty of 1945.

"C"

In upholding the principles of China's sovereignty and independence on the diplomatic front, the Nationalists make a strong appeal to Chinese and foreign opinion and further substantiate their propaganda claim that China's existence is menaced by world Communism. Meanwhile, the Chinese Communists are left with the task of defending a potentially disadvantageous trade arrangement. In addition, they are confronted with the implications of a developing political schism between Manchuria and the rest of China implicit in the delegation of local Manchurian authorities to conclude an international agreement in Moscow.

THAILAND

Government unhappy over MAP--The current MAP proposal, which would make US arms and equipment available to Thailand on a reimbursable basis, has been received with little enthusiasm in Thailand. Because it would make US military support available only on the same basis that it is now available from the UK, Sweden and numerous private arms dealers, the proposal is being interpreted in Thailand as further evidence that the US is not greatly concerned about the fate of Thailand or of Southeast Asia as a whole. Development of an attitude of futility and fatalism among important political and military figures in Thailand continues to be accelerated by: (1) the rapid changes in China and the loss of US influence there, (2) the presence within Thailand of a large and economically powerful Chinese minority which is being subverted by a well-organized Chinese Communist group, (3) the presence of scattered bands of Chinese Communists and mercenaries along Thailand's northern and southern borders, and (4) unrest in neighboring countries.

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Although the Thai Government has taken an anti-Communist stand and although Thailand's political and economic structure contains relatively few elements conducive to the acceptance of Communism, it is hardly to

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be expected that Thailand will be able or willing to resist an accommodation with Communist China if present trends continue.

INDONESIA

Agreement on many major issues probable at The Hague--The forthcoming roundtable conference, which is expected to begin about 25 August at The Hague represents a real milestone towards the possible settlement of the Indonesian problem. While Federalists as well as Republicans will be represented at the conference, any settlement will depend upon solution of the basic differences which have existed between the Republic of Indonesia and the Netherlands since 17 August 1945, the date when the Republic declared itself independent. "B"

Foremost among these differences is the question of sovereignty. The Republicans take the stand that they have already acquired all the attributes of sovereignty. The possibility of a settlement of this point has been improved slightly by the Dutch indication of a willingness to shorten the interim period, to transfer sovereignty to a united Indonesia early in 1950 and to set the exact date for the transfer at the conference. The fact that details of the proposed Indonesian federation's structure were agreed upon by both Republicans and Federalists at an All-Indonesian conference prior to the departure of the Indonesian delegates also should make a settlement of the sovereignty issue somewhat easier.

In the field of foreign relations, agreement has been complicated by the independence of action exercised by the Republic, particularly the appointment of a Republican Consular official at Manila in July. Another crucial point, in contrast, the problem of maintaining the identity of the Republican Army, may have been simplified by the agreement already reached between the Federalists and the Republicans on the composition of a federal army, as well as by the Dutch announcement that there will be a withdrawal of Netherlands troops from Indonesia.

Delineation of the Republican territory within a federated Indonesia certainly will be a major problem. Many Republicans feel that their areas have been unduly compressed in the last two years, and they may resent transfer of authority over sizeable Republican regions in Sumatra to Dutch-sponsored states there. The extent to which Republican forces comply with last week's cease-fire order, particularly in Sumatra, which will serve to illustrate Republican ability to control the populace in disputed areas, may well serve as a basis for their claims to territory.

The most complex problems to be considered will be those of an economic and financial nature. Aside from divergent viewpoints in regard to economic

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policy, the question of financing an independent Indonesia will be of primary importance. Dutch financial experts have declared that unless sufficient credit for adequate supplies of goods is obtained, it will be impossible to maintain normal economic conditions in Indonesia. Foreign debts of the Dutch-controlled Indonesian Government, from the time of the Japanese surrender to the end of 1949, moreover, will amount to \$1 billion, which raises the immediate question of the extent to which the new Indonesian federal government will assume this debt as well as the extent to which provisions will be made for settlement of the rights of foreign investors in Indonesia.

Once all these problems relating to sovereignty have been solved, the formation of a Netherlands-Indonesian Union will be discussed and, if obstacles to its formation are overcome, consideration will be given to the granting of military bases to the Netherlands.

Although the basic issues of the Indonesian conflict have remained essentially the same since the formation of the Republic, the current negotiations at The Hague will be taking place in a more congenial atmosphere than has prevailed at earlier formal discussions. Dutch leaders have adopted a more conciliatory attitude toward Indonesia within recent months, many impediments present in previous negotiations have been removed, and preliminary agreements, already reached between the Republicans, the Dutch and the Federalists, should facilitate the work of the conference. Barring serious incidents in Indonesia, an agreement settling many of the major issues seems probable.

PHILIPPINES

Philippine financial picture darkens--The Philippine financial situation apparently has become more critical than at any time since the summer of 1946, when the US was obliged to authorize a \$75 million loan for Philippine budgetary purposes. According to press reports, the current deficit in the Government's General Fund amounts to \$26 million, approximately one-fifth of the national budget. It appears that Government operations are being financed by drawing on certain Government trust funds and by borrowing from the Central Bank.

"C"

Falling revenues largely account for the deficit, although it is in part the result of increased expenditures for educational facilities authorized by Congress in 1948 but not included in the budget. The Government's financial troubles also reflect the continued serious imbalance in Philippine foreign trade. Tentative figures for the first half of 1949 indicate a visible trade deficit of at least \$144.8 million, only partly offset by US Government expenditures on rehabilitation. During this same

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half-year, national revenues declined by nearly one fifth.

Although import controls were instituted in January, 1949, they have had little effect in bringing about a trade balance, particularly in view of a 45% drop in the price of copra, the Philippines' number-one postwar export. The Secretary of Finance and the Governor of the Central Bank are pressing for wider application of import controls, and the latter has suggested the possible need of applying exchange controls to protect the dollar balances. According to the US-Philippine Trade Agreement, however, the free convertibility of pesos to dollars may not be suspended except by agreement with the President of the US.

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